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DESCRIPTION OF
PROPOSED AMENDMENT TO H.R. 4333 AS AMENDED

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

July 13, 1988

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of a possible proposed additional amendment to H.R. 4333 as amended (the Technical Corrections Act of 1988).

Part I of the document describes the additional provisions involving revenue reductions, and Part II describes additional revenue raisers.

A separate staff document presents estimated revenue effects of the provisions described in this document.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Proposed Amendment to H.R. 4333 as Amended (JCX-15-88), July 13, 1988.

I. ADDITIONAL ITEMS INVOLVING REVENUE REDUCTIONS

A. Modifications to Prior Committee Decisions

1. Limitation of $1,500 on employer-provided educational assistance

Present Law

Under present law, an individual may (subject to the two-percent floor on nonreimbursed employee expenses) deduct from income amounts expended for education if the education is job-related (sec. 162). Education is job-related if it (1) maintains or improves skills required for the employee's job, or (2) meets the express requirements of the individual's employer that are imposed as a condition of continued employment in the same job. Job-related education expenses that are reimbursed by an individual's employer are excludable from gross income. Educational assistance provided by the employer that is not job-related is includible in income.

Under prior law (taxable years beginning before January 1, 1988), an employee's gross income for income and employment tax purposes did not include amounts paid or incurred by the employer for educational assistance provided to the employee (without regard to whether the education was job-related) if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements (sec. 127). This exclusion, which expired for taxable years beginning after December 31, 1987, was limited to $5,250 of educational assistance with respect to an individual during a calendar year and did not apply to education involving sports, games, or hobbies. (References below to the exclusion for educational assistance are to this exclusion under sec. 127.)

In 1984, Congress required that employers file information returns with respect to educational assistance programs under section 127 (sec. 6039D). The purpose of this requirement was to collect data with respect to the use of such programs to provide Congress with a means to evaluate the effectiveness of the exclusion.

Under the prior Committee amendment, the exclusion for educational assistance would be restored retroactively to the date of expiration and would be extended so that it expires for taxable years beginning after December 31, 1990. However, the exclusion would not apply to education leading to a postgraduate degree (other than for graduate teaching or research assistants). In addition, the prior amendment would clarify the definition of education ineligible for the exclusion--i.e., education involving sports, games, or

hobbies. Also, the educational assistance exclusion would be phased out for high-income taxpayers.

Description of Proposal

The amendment would reduce the prior-law $5,250 limitation on educational assistance to $1,500. The amendment also would delete the prior Committee amendment phasing out the educational assistance exclusion for high-income taxpayers.

Reasons for Change

The exclusion for educational assistance should be limited to $1,500, because available data indicate that such a limit is sufficient to address the educational needs of most low- and middle-income employees.

Effective Date

The $1,500 limit would apply to calendar years after 1988.

2. Change in H.R. 4333 effective date regarding outbound corporate reorganizations of U.S. corporations into foreign corporations under General Utilities--transactions completed prior to June 21, 1988

Present Law

Gain is recognized to a liquidating corporation in the case of a liquidating distribution to an 80-percent distributee that is a foreign corporation, unless regulations provide otherwise. It is expected that such regulations may permit nonrecognition if the potential gain on the distributed property at the time of the distribution is not being removed from U.S. taxing jurisdiction prior to recognition.

A technical correction under H.R. 4333 would clarify that a transfer of property to a foreign corporation in a transaction that would otherwise qualify as a tax-free reorganization is treated in the same manner as a liquidating transfer of such property to an 80-percent foreign corporate distributee. No gain will be recognized, however, if the U.S. corporate transferor is 80-percent controlled (within the meaning in section 368(c)) by five or fewer domestic corporations, subject to such basis adjustments and such other conditions as shall be provided in regulations to prevent the removal of corporate appreciation from U.S. taxing jurisdiction. This technical correction would apply to transactions occurring after June 10, 1987.

Description of Proposal

The proposal would apply the technical correction to transactions occurring on or after June 21, 1988.

3. Treatment of depreciation by certain lessors under the minimum tax preference for adjusted current earnings

Present Law

Corporations are subject to an alternative minimum tax payable, in addition to all other tax liabilities, to the extent it exceeds the corporation's regular tax. The tax is imposed at a flat rate of 20 percent on alternative minimum taxable income in excess of an exemption amount. Alternative minimum taxable income generally is the taxpayer's taxable income, increased or decreased by certain adjustments and preferences. For taxable years beginning after 1989, three-fourths of the excess of adjusted current earnings over other alternative minimum taxable income is a preference.

In computing adjusted current earnings, a corporation is generally allowed the lesser of the alternative depreciation system or the depreciation used for book purposes. H.R. 4333, as introduced, provides that in the case of a lessor of property where the income of the taxpayer is determined without regard to the allowance for depreciation, the depreciation for book purposes is treated as the amount which would reduce the income from the lease to the net income shown for book purposes.

Description of Proposal

The proposal would delete the provision in H.R. 4333. The committee report would state that a depreciation allowance is intended in the case of leased property under the adjusted current earnings provision, notwithstanding the absence of such an allowance in computing book income.

Reasons for Change

The provision in H.R. 4333 concerning the treatment of depreciation under the adjusted current earnings provision does not compute an adequate allowance for depreciation in some cases, and therefore the provision should be deleted.

Effective Date

The provision would apply to taxable years beginning after December 31, 1989.

4. Valuation of health benefits--nondiscrimination rules (HMOs)

Present Law

Under present law, new nondiscrimination rules apply to employer-provided accident or health coverage. For purposes of these rules, the Secretary is to establish tables prescribing the relative values of different types of accident or health coverage.

Under the introduced bill, any rules issued by the Secretary with respect to the valuation of accident or health coverage are effective as of the later of (1) the first plan year beginning at least 6 months after issuance of such rules, or (2) the effective date specified by the Secretary for such rules. In addition, the bill provides a temporary special valuation rule for accident or health coverage that applies prior to the effective date of rules issued by the Secretary.

Under the prior Committee amendment, the temporary special valuation rule would apply to all years beginning before January 1, 1991, without regard to whether the Secretary issues different valuation rules prior to such date.

In addition, under the prior Committee amendment, the Secretary would be directed, in prescribing the value of health benefits for the period when the temporary special valuation rule no longer applies, to take into account any managed care aspects of such benefits. For example, because of such managed care aspects, a health maintenance organization (HMO) may be able to provide greater health care coverage than an indemnity plan at the same cost to the employer. A valuation technique that focused only on plan coverages could thus overvalue the HMO. (This issue is implicitly addressed in the temporary special valuation rule because employers are permitted to use a plan's cost as its value.)

Description of Proposal

The proposal would delete that portion of the prior amendment that directed the Secretary, in prescribing the value of health benefits when the period after the temporary special valuation rule no longer applies, to take into account any managed care aspects of such benefits.

Reasons for Change

The effect, if any, on health benefit valuation of managed care aspects is an issue that has not been fully developed and generally is an issue more appropriately addressed by the Secretary after careful study.

Effective Date

This provision would apply as if included in the Tax Reform Act of 1986.

5. Eligible deferred compensation plans (sec. 457 plans)

Present Law

Under present law, unfunded deferred compensation that is provided by a State or local government or by a nongovernmental tax-exempt organization is subject to certain special rules (sec. 457). Under these special rules, the treatment of unfunded deferred compensation depends on whether the deferred compensation is provided under an eligible deferred compensation plan. To qualify as an eligible deferred compensation plan, a plan is required to satisfy certain requirements with respect to, for example, the maximum amount of deferrals that may be made by any participant in any year.

Unfunded deferred compensation provided under an eligible deferred compensation plan is includible in the income of the individual performing services (or his or her beneficiary) in the year in which it is paid or made available. On the other hand, with respect to any State or local government or nongovernmental tax-exempt organization, any unfunded deferred compensation not provided under an eligible deferred compensation plan is includible in income when and to the extent that it is not subject to a substantial risk of forfeiture.

It was the Tax Reform Act of 1986 that applied section 457 to nongovernmental tax-exempt organizations.

Description of Proposal

Under the amendment, the provision in the 1986 Act applying section 457 to nongovernmental tax-exempt organizations would be repealed. In addition, as under the prior Committee amendment, the position of the IRS in Notice 88-68 would be codified and section 457 would not apply to bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, and death benefit plans.

Further, section 457 would also not apply to nonelective deferred compensation deferred pursuant to an agreement that (1) was in writing on July 13, 1988, and (2) on such date provided for a deferral for each taxable year covered by the agreement of a fixed amount or an amount determined pursuant to a fixed formula. This rule ceases to apply in the year in which the amount or formula is modified. In addition, this rule only applies to individuals who were covered by the agreement on July 13, 1988.

Finally, the Treasury Department would be required to perform a study (to be completed by March 1, 1989) regarding the proper tax treatment of all types of deferred compensation of employees of and other persons providing

services for State and local government and tax exempt organzations.

Reasons for Change

It is appropriate to exempt nongovernmental tax-exempt organizations from section 457 in order to preserve their ability to compete for qualified personnel with private taxable employers.

The exemption for existing nonelective deferred compensation agreements recognizes that prior to January 26, 1987, many taxpayers were not aware of the IRS position (as published that day in IRS Notice 87-13) that nonelective deferred compensation is subject to section 457. Therefore, agreements were entered into based on the assumption that section 457 did not apply to nonelective deferred compensation.

In addition, it is appropriate to further study deferred compensation issues and section 457 in order to determine the appropriate scope of the provision.

Effective Date

The provision would apply to taxable years beginning after December 31, 1986.

6. Transitional exception for qualified mortgage bond proceeds committed to homebuilders, etc. as of June 23, 1988

Present Law

The committee bill provides that the special subsidy provided by qualified mortgage bonds is recaptured on disposition of the house within ten years after the financing is provided. This recapture is imposed on the individual mortgagor and does not affect the tax-exempt status of the underlying bond issue. The recapture would apply to loans made to mortgagors after December 31, 1988.

Description of Proposal

The proposal would exempt from the recapture requirement borrowers receiving loans after December 31, 1988, if the loans are made pursuant to binding contracts with homebuilders, lenders, or mortgagors entered into before June 23, 1988, and if the bonds were either (a) issued before that date or (b) issued before August 1, 1988, pursuant to applications for State bond volume authority made before July 1, 1988. For purposes of this rule, a contract would be treated as binding if applications for funds had been made, nonrefundable commitment fees (points) paid, and all other conditions for a binding contract (other than receipt of State bond volume authority allocations) satisfied before June 23, 1988.

Effective Date

The proposal would amend the previously adopted provision of the committee bill applicable to financing provided after December 31, 1988.

7. Certain transition rule to require inclusion of a non-profit health center

Transitional exceptions for a Boston, Massachusetts low-income housing project would be clarified by statutorily requiring that an originally promised non-profit health clinic be included in the project.

8. Delete Rhode Island Rehabilitation project rule from 1986 Reform Act

A transitional exception for a Newport, Rhode Island rehabilitation project would be deleted from the technical corrections bill at the request of the original sponsor.

9. Allocation and apportionment of foreign research expenses

Present Law

For purposes of determining taxable income from U.S. sources and taxable income from foreign sources, a taxpayer that performs 50 percent or more of its research and development activities in the United States may automatically allocate at least 30 percent of its expenses for conducting research outside the United States (foreign research expenses) against U.S. source gross income.

The committee has agreed on a bill providing, among other things, for the automatic allocation of 64 percent of expenses of conducting research in the United States (U.S. research expenses) to U.S. source gross income, and 67 percent of foreign research expenses to foreign source gross income.

Description of Proposal

In order to conform to the committee's action on U.S. research expenses, the proposal would automatically allocate only 64 percent of foreign research expenses to foreign source gross income.

10. 50-year amortization of railroad grading and tunnel bores

Present Law

The Tax Reform Act of 1986 repealed the prior-law election to amortize costs of railroad grading and tunnel bores over 50 years. The conference report stated that no amortization or depreciation deduction for railroad grading and tunnel bores will be allowed. The technical corrections bill denies such deductions, in accordance with the legislative history of the 1986 Act.

Description of Proposal

Costs of railroad grading and tunnel bores would be amortized over 50 years for both regular tax and minimum tax purposes.

As in the case of other assets, the Treasury Department would be directed to monitor and analyze actual experience with respect to these assets and may prescribe a new life for this property. Any new recovery period prescribed by Treasury would only apply to property placed in service after December 31, 1991.

Effective Date

The provision would be effective as if enacted with the Tax Reform Act of 1986.

11. Tax on built-in gain of S corporations: suspension of tax in case of post-conversion losses

Present Law

A corporate level tax is imposed on gain that arose prior to the conversion of a C corporation to an S corporation ("built-in gain") that is recognized by the S corporation within 10 years after the date on which the election took effect. The total amount of gain that is subject to the tax is limited to the aggregate net built-in gain of the corporation at the time of the conversion to S status.

The 1986 Act provided that the recognized built-in gain is not taxed in a year to the extent it exceeds the taxable income of the corporation computed as if the corporation were a C corporation. The technical corrections bill (H.R. 4333) would remove this "net income" limitation and thus would not permit post-conversion deductions that are not attributable to the period of C corporation status to offset the tax on built-in gains that are attributable to that period.

Description of Proposal

The provision would retain the net income limitation of the Act, so that a corporation would not pay tax on built-in gains in any year in which post-conversion losses offset those gains. However, if the corporation subsequently has post-conversion income within the 10-year recognition period, that income would be subject to the built-in gains tax, to the extent of pre-conversion built-in gain that was not taxed due to this net income limitation.

Reason for Change

It is considered appropriate to grant relief from the built-in gains tax in years in which corporations experience post-conversion losses. However, to limit the potential for complete avoidance of the built-in gain tax through the timing of post-conversion losses, the built-in gains tax should be collected in subsequent years within the recognition period when there is taxable income.

Effective Date

The provision would be effective for S elections made on or after March 31, 1988.

B. Individual Provisions

1. Treatment of payments to colleges for right to purchase athletic tickets

Present Law

A payment to or for the use of a college, university, or other qualified organization is deductible as a charitable contribution under section 170 only to the extent it is a gift--i.e., a voluntary transfer of money or property without receipt or expectation of financial or economic benefit. As a general rule, where consideration in the form of admissions or other privileges or benefits is received in connection with payments by patrons of fundraising activities, the payments are presumed not to be gifts. In such a situation, the burden is on the taxpayer to establish that the amount paid does not constitute the purchase price of the privileges or benefits and to establish what part (if any) of the payment in fact qualifies as a contribution.

The IRS has issued guidelines (Rev. Rul. 86-63) concerning whether payments to athletic scholarship programs constitute charitable contributions deductible under section 170 when the payments afford the right to purchase preferred seating at a college's home football games. Under these guidelines, for example, no deduction generally is allowable where the games regularly are sold out in advance and hence no ticket would have been readily available to the taxpayer had the taxpayer not made a payment to the college's athletic scholarship program.

Description of Proposal

If a taxpayer makes a payment to or for a college or university that would be deductible as a charitable contribution but for the fact that the taxpayer thereby receives (directly or indirectly) the right to purchase seating in an athletic stadium of such institution, 80 percent of such payment would be treated as a charitable contribution. No amount paid for the actual purchase of tickets, however, would be deductible under section 170. The proposal would not apply where a taxpayer receives tickets or seating in return for the payment.

For example, assume that a taxpayer who itemizes makes a $300 payment to a tax-exempt athletic scholarship program maintained by a university. A minimum payment of $300 is required to become a "member" of the program. The only benefit afforded members is that they are permitted to purchase, by paying the stated price of $120, a season ticket to the university's home football games in a designated area in the stadium. Because the games regularly are sold out well in advance, tickets to the games covered by the season

ticket would not have been readily available to the taxpayer had not payment to the program been made. The $300 membership fee is paid annually, and a member is required to make a separate $300 payment with respect to each season ticket the member purchases.

Under the proposal, the taxpayer could claim $240 (80 percent of the $300 payment) as a charitable deduction. The taxpayer could not claim a charitable deduction for the remainder of the $300 payment ($60) or for any part of the $120 purchase price of a season ticket. The same tax consequences also would apply under the proposal-even if, in the above example, tickets to games would have been readily available whether or not the taxpayer had made the $300 payment to the athletic scholarship program.

Reasons for Change

The proposal would eliminate otherwise unavoidable valuation controversies between the IRS and many individual taxpayers as to the proper treatment of payments to college athletic scholarship programs.

Effective Date

The provision would apply retroactively to amounts paid in taxable years beginning after December 31, 1983 (the effective date of the original IRS ruling on this issue).

2. Special mileage allowance for rural letter carriers

Present Law

Taxpayers who own an automobile and use it for business purposes are entitled to deduct the business portion of the actual operation and maintenance expenses, plus depreciation. Alternatively, the taxpayer may elect to utilize a standard mileage rate in computing the deduction. This rate--22.5 cents-per-mile in 1987--multiplied by the number of miles driven for business purposes equals the taxpayer's deduction, which is taken in lieu of deductions for depreciation and actual operation and maintenance expenses. (IRS announces the standard mileage rate applicable to a taxable year in the Fall of that taxable year.)

If business use of the automobile is not greater than 50 percent of total use, the taxpayer may not use accelerated depreciation. The taxpayer is limited to straight-line depreciation over a 5-year period for the business-use portion of the automobile's basis.

Rural mail carriers generally use their own vehicles (rather than Postal Service vehicles) to deliver mail. The Postal Service provides each rural mail carrier with equipment and maintenance allowance payments which are included in taxable income.

Description of Proposal

Rural mail carriers of the U.S. Postal Service would be allowed to compute their deduction for business use of their vehicle by using 150 percent of the standard mileage rate, i.e., 33.75 cents per mile for 1987. The provisions relating to eligibility for accelerated depreciation would not be changed by this proposal.

Reasons for Change

Rural mail carriers are required to provide their own automobiles. Rural mail routes require travel over unimproved roads and improved roads that often are in need of major repair, and thus the rural mail carrier could experience higher than ordinary auto repair and maintenance costs.

Effective Date

The provision would apply to taxable years beginning after December 31, 1987.

3. Extension of nonrecognition of gain rule to surviving spouse

Present Law

In general, a taxpayer may defer recognition of gain on the sale of a principal residence if the taxpayer reinvests the sale price of the old residence in a new principal residence within a specified period of time.

This nonrecognition of gain does not apply under present law if one spouse dies after the date of sale of the old residence and before the date of purchase of the new residence.

Description of Proposal

The present-law nonrecognition of gain rule would apply where the surviving spouse purchases a new principal residence within the period of time specified in section 1034.

Reason for Change

It is inconsistent with the intention of nonrecognition of gain to deny its protection to a surviving spouse because the deceased spouse did not live long enough to complete the sale-and-purchase requirement.

Effective Date

The provision would apply to the sale of an old residence by a surviving spouse after December 31, 1984.

4. Full deductibility of business meals provided to employees on certain drilling rigs

Present Law

Under the 1986 Act, an otherwise allowable business deduction for any expense for food or beverages (including employer-provided meals to employees) is reduced by 20 percent, subject to certain exceptions (sec. 274(n)).

Description of Proposal

The percentage reduction rule would not apply to an otherwise allowable deduction for expenses of food or beverages that are provided on an oil or gas platform or drilling rig if such platform or rig is located either offshore or in the United States north of the 54th parallel.

Reasons for Change

In light of the high costs necessarily imposed on an employer in providing meals to its employees on an oil or gas platform or drilling rig that is located offshore or in the United States north of the 54th parallel, it is appropriate to allow full deductibility of such food and beverage costs.

Effective Date

The provision would apply for taxable years beginning after December 31, 1987.

5. Innocent spouse relief

Present Law

Under present law, as amended by the Tax Reform Act of 1984, a spouse filing a joint return is relieved of liability for tax if there is a substantial understatement of tax attributable to a grossly erroneous item of the other spouse, the spouse establishes that in signing the return he or she did not know, and had no reason to know, that there was a substantial understatement, and taking into account all the facts and circumstances it is inequitable to hold the spouse liable for the deficiency in tax attributable to the the understatement.

Description of Proposal

In the case of a joint return filed before January 1, 1985, on which there is an understatement attributable to disallowed deductions of the other spouse the amount of which exceeds the taxable income shown on the return, if the spouse establishes that in signing the return that he or she did not know or have reason to know that there was such an understatement, and the marriage was terminated and the net worth of the spouse immediately following the termination of the marriage was less than $10,000, the spouse is relieved of liability for tax including interest, penalties, and other amounts for the year to the extent the liabliity is attributable to the understatment. A refund will be allowed notwithstanding any law or rule of law, including the application of res judicata.

Reasons for Change

Relief is appropriate for certain spouses filing joint returns where the income was attributable to the one spouse and it would be inequitable to collect from the other spouse because that spouse is left with little funds remaining after the marriage has terminated.

Effective Date

The proposal would apply to returns filed before January 1, 1985.

6. Interim treatment of certain amounts awarded under the Christa McAuliffe Fellowship Program

Background

Under the Christa McAuliffe Fellowship Program, the Federal Government awards fellowships annually to outstanding teachers (20 U.S.C. 1113). Recipients are limited to not more than one public or private school teacher in each Congressional District. The amount of the award cannot exceed the average national salary of public school teachers. In the first year of the program (ended June 30, 1988), a total of $2 million was awarded to 115 fellowship recipients.

The fellowship award may be used only for an education improvement project approved by the Department of Education. Project purposes may include (1) development of special innovative programs, (2) consultation with or assistance to other school districts, (3) model teacher programs and staff development, or (4) sabbaticals for study or research, or academic improvement. Under the program as currently structured, checks made out to the teacher are issued on the basis of monthly budget submissions showing amounts needed for purposes of the approved project. A recipient who does not return to teaching in his or her school district for at least two years after the fellowship year must repay the award.

To date, almost all recipients have continued their teaching jobs during their fellowship year. More than 75 percent of recipients are described as using their grants in full or in part for "hands-on" teaching projects in schools.

Present Law

The Federal statute establishing the McAuliffe Fellowship Program did not include rules for the Federal income tax treatment of program awards. In general, nonscholarship awards are includible in the recipient's gross income.

Description of Proposal

The proposal would provide express rules for the Federal income tax treatment of amounts received, through June 30, 1990, pursuant to the McAuliffe Fellowship Program.

Under the interim provision, the amount of a Christa McAuliffe Fellowship that is expended, in accordance with the terms of the grant, on an approved school project for the benefit and use of a school or school system would be treated as a grant to the school, and hence would not be includible in the teacher's gross income. Any amount retained or used for the benefit of the teacher, such as for a sabbatical trip

or as compensation for working on the project, would be includible in the teacher's gross income.

This interim provision would allow the Federal Government to restructure the payment procedures for the awards so that the tax treatment could be determined in accordance with generally applicable rules of present law. For example, where fellowship funds are used to purchase science equipment for use at the school, the check for such expenditures could be issued by the Department of Education directly to the school. Prior to termination of the interim rules, the Department would seek guidance from the IRS that such payments would not be includible in the teacher's gross income.

Reasons for Change

Under the McAuliffe Fellowship Program, a recipient may use award funds only on the specific project approved by the Department of Education in selecting the recipient--for example, to purchase equipment and supplies for a school to be used for teaching science to students at that school. To the extent the recipient expends funds for the benefit and use of a school pursuant to an approved project, the fellowship award in substance constitutes a grant from the Federal Government to the school, from which the teacher derives no personal benefit. Accordingly, in light of the restrictions placed on use of fellowship funds and the particular facts involved, it is appropriate to treat fellowship amounts as not paid to the teacher to the extent the amounts are expended (in accordance with the terms of an approved project) for the benefit and use of the school and not for the benefit or use of the fellowship recipient.

However, if the recipient retains or uses fellowship funds for his or her personal benefit, such amounts should be includible in the recipient's gross income. For example, fellowship funds used to pay for sabbatical expenses, or as compensation for time spent by the recipient in carrying out the approved project, would be includible in income.

Effective Date

The proposal would be effective for amounts received prior to July 1, 1990.

C. Depreciation/Investment Tax Credit

1. Extension of placed-in-service date for certain property benefiting from depreciation and investment tax credit transitional relief in Tax Reform Act of 1986

Present Law

Transitional exceptions to the amendments made by the Tax Reform Act of 1986 to the depreciation and investment tax credit provisions of the Code were provided for property that was the subject of a binding contract or was under construction on March 1, 1986. Additional exceptions were provided for other property that satisfied specifically described requirements in the 1986 Act. Property eligible for this transitional relief is required to be placed in service before prescribed dates, depending on the specific type of property involved. Present law includes no mechanism for extending these placed in service deadlines.

Description of Proposal

The proposal would authorize the Treasury Department to extend the prescribed placed in service deadlines for up to two years for certain property that satisfies the requirements of the 1986 Act for transitional relief from the depreciation and ITC amendments where it is not possible to meet a prescribed deadline due to an Act of God or to inordinate delay in receipt of Federal approval.

First, additional time would be provided where (1) construction of property commenced before July 13, 1988; (2) during construction the property was substantially destroyed as a result of an Act of God; and, (3) the Treasury Department determines, based on facts and circumstances, that additional time, not exceeding two years, to place the property in service is warranted.

Second, additional time would be provided where (1) the Federal Government is required to give regulatory approval before property can be placed in service; (2) all necessary applications for Federal approval were filed before the date by which the 1986 Act required a binding contract to exist or construction to have commenced; (3) final approval is granted by the applicable Federal agency before August 1, 1988; and (4) the Treasury Department determines, based on facts and circumstances, that the Federal approval was inordinately delayed and that additional time, not exceeding two years, to place the property in service is warranted.

Effective Date

The proposal would apply as if included in Title II of the Tax Reform Act of 1986.

D. Corporate Provisions

1. Woods Investment effective date--clarification that weekends and holidays are excluded

Present Law

The 1987 Act changed the manner in which a parent corporation's basis in the stock of a corporation with which the parent has filed a consolidated tax return is determined, for purposes of determining gain or loss on the parent corporation's disposition of such stock. The provision is generally effective for dispositions after December 15, 1987, except that transition relief is provided for dispositions pursuant to certain arrangements or events that occurred prior to that date, provided the disposition occurs before January 1, 1989. December 31, 1988 is a Saturday.

Section 7503 of the Code provides that where the last day for an act required by the tax laws is a Saturday, Sunday, or a legal holiday, the act will be considered timely if it is performed on the next day that is not a Saturday, Sunday or legal holiday. It is not clear whether or to what extent this provision would apply to the requirement that the disposition required for transition relief must occur prior to January 1, 1989.

Description of Proposal

For purposes of transition relief from the provision regarding the computation of gain or loss on a disposition of stock where the corporations have filed a consolidated tax return, a disposition would be treated as if it occurred on December 31, 1988 if it occurs on the next day following December 31, 1988 that is not a Saturday, Sunday, or a legal holiday. Such a disposition would also be treated as occurring on December 31, 1988 for purposes of other income tax provisions (including the determination of the taxable year of the buyer or of the seller in which the transaction occurred and any resulting item of income or loss is recognized). No inference is intended as to present law or as to the application of section 7503 to any other requirement of the tax laws.

Reason for Change

December 31, 1988 is a Saturday. In the case of dispositions under this provision, the committee believes it is appropriate to provide that the transaction may be completed on the next business day.

Effective Date

The provision would be effective as if enacted with the 1987 Act.

2. Regulatory authority to provide access to refunds to statutory or court-appointed fiduciary of insolvent members on consolidated tax return

Present Law

The Treasury Department has broad regulatory authority to prescribe regulations governing the treatment of corporations in an affiliated group filing a consolidated tax return.

Under existing Treasury Regulations, the common parent of an affiliated group filing a consolidated return is the agent of all members of the group in matters before the Internal Revenue Service. This common parent agency provision generally requires a refund attributable to losses of any member to be paid by the Internal Revenue Service to the parent corporation.

Description of Proposal

The Treasury Department is authorized to provide access to tax refunds to a statutory or court appointed fiduciary of an insolvent member of a group of corporations filing a consolidated tax return.

Reasons for Change

If a member of an affiliated group of corporations filing a consolidated return is subject to a statutory or court-appointed receivership or similar fiduciary relationship, the fiduciary may have difficulty obtaining access to tax refunds attributable to that member's losses, due to the operation of the common parent agency provision.

It is desirable to improve the access of such fiduciaries to such refunds, in a manner consistent with the purposes of the consolidated return provisions.

Effective Date

The provision would be effective for pending or future statutory or court appointed fiduciary situations, in accordance with regulations promulgated under the Treasury Department's consolidated return regulatory authority.

E. Minimum Tax

1. Treatment of bankruptcy and insolvency restructurings under the minimum tax book preference

Present Law

Corporations are subject to an alternative minimum tax payable, in addition to all other tax liabilities, to the extent it exceeds the taxpayer's regular tax. The tax is imposed at a flat rate of 20 percent on alternative minimum taxable income in excess of an exemption amount. Alternative minimum taxable income generally is the taxpayer's taxable income, increased or decreased by certain adjustments and preferences.

One-half of the excess of pre-tax book income of a corporation over other alternative minimum taxable income is a preference for taxable years beginning in 1987 to 1989. If a corporation reports debt discharge income on its financial statement, it may incur a minimum tax liability under this provision.

Description of Proposal

The proposal provides that the transfer of a corporation's own stock to its creditors in exchange for the corporation's debt in a Title 11 case (or to the extent the corporation is insolvent) does not give rise to adjusted net book income. Thus a bankrupt or insolvent corporation will not incur a minimum tax liability by reason of transferring its stock to creditors.

Reasons for Change

Corporations that restructure their capital by issuing stock to their creditors in a bankruptcy case or to the extent insolvent should not incur a tax liability.

Effective Date

The provision applies to taxable years beginning after December 31, 1986.

2. Minimum tax treatment of structured settlement arrangements

Present Law

The adjusted current earnings provision of the corporate minimum tax requires the inclusion of the income on any annuity contract (as determined under sec. 72(u)(2) (defining income on the contract)). The adjusted current earnings provision does not incorporate the section 72(u)(3)(C) exception in the case of annuity contracts that are qualified funding assets in connection with structured settlement arrangements.

Description of Proposal

Under the proposal, an exception is provided for the inclusion of income on annuity contracts under the adjusted current earnings provision, in the case of an annuity contract that is a qualified funding asset within the meaning of section 130(d) (without regard to whether there is a qualified assignment).

Reasons for Change

Structured settlement arrangements are essentially conduit arrangements and thus the exclusions provided under the regular tax for income on annuity contracts used to fund such arrangements are equally appropriate in the minimum tax, including the adjusted current earnings provision.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1986.

F. Accounting Provisions

1. Uniform capitalization rules

a. Exemption of expenses of free-lance authors, artists, and photographers from the uniform capitalization rules

Present Law

In general, uniform cost capitalization rules apply to the production of all tangible personal property and to the purchase and holding of property for resale. These rules generally are designed to provide an accurate measure of income for any taxable year by deferring the deduction of costs until the taxable year in which income is recognized through the sale or use of the property to which the costs relate.

For purposes of the uniform capitalization rules, tangible personal property includes a film, sound recording, video tape, book, or similar property. The Internal Revenue Service has provided an elective simplified method for deducting business expenses of authors, artists, photographers, and other similarly situated persons who incur expenses in producing creative properties. Under this method, eligible taxpayers generally may deduct 50 percent of their business expenses in the year in which incurred and 25 percent in each of the two succeeding years.

Description of Proposal

The uniform capitalization rules would not apply to any otherwise deductible expense paid or incurred by an individual engaged in the business of being a writer, artist, or photographer. The exemption would apply only to the individual whose personal efforts create (or may reasonably be expected to create) a literary manuscript, musical or dance score, picture, painting, sculpture, statue, etching, drawing, cartoon, graphic design, original print edition, photograph, or photographic negative or transparency. The exemption would not apply to the expenses of a person paid or incurred in the person's capacity as an employee. Expenses incurred by a qualified employee-owned corporation that directly relate to the activities of a qualified employee-owner would qualify to the extent the expenses would qualify if incurred directly by the employee-owner.

Reasons for Change

It is inequitable to apply the uniform capitalization rules to authors, artists, and photographers while other taxpayers performing personal services are not subject to the same rules. For example, attorneys and consultants may

provide a written product and receive payment several years after the completion of such product. The uniform capitalization rules would not apply to the costs of such written product.

In addition, the application of the uniform capitalization rules to authors, artists, and photographers is unduly burdensome for those authors, artists, and photographers who do not elect the simplified method provided by the Internal Revenue Service. The otherwise deductible expenses of these authors, artists, and photographers must be allocated among each project and generally are deductible over the period that income is estimated to be derived from the project.

Effective Date

The provision generally would apply to costs incurred after December 31, 1987, in taxable years ending after such date.

b. Exemption of expenses of certain producers of animals from the uniform capitalization rules

Present Law

In general, uniform cost capitalization rules apply to the production of property and to the purchase and holding of property for resale. In the case of any animal that is produced by a taxpayer in a farming business, the uniform capitalization rules apply only if (1) the animal has a preproductive period of more than two years or (2) the taxpayer engaged in the farming business is a corporation, partnership or tax shelter that is required to use an accrual method of accounting.

Taxpayers engaged in a farming business that are not required to use an accrual method of accounting may elect to deduct currently the costs relating to the production of the animal. If this election is made, gain from the disposition of the animal is taxed as ordinary income to the extent of prior deductions that would have been capitalized. In addition, an electing taxpayer must use the alternative depreciation system (which provides for straight-line cost recovery over a longer recovery period than generally applies) for all farm assets that are placed in service in taxable years for which the election is in effect.

Description of Proposal

The uniform capitalization rules would not apply to otherwise deductible expenses that are incurred by a taxpayer in connection with the production of animals in any farming business other than a farming business of a corporation, partnership or tax shelter that is required to use an accrual method of accounting.

Effective Date

The provision generally would apply to costs incurred after December 31, 1988, in taxable years ending after such date.

c. Election of producers of pistachio nuts to deduct preproductive period costs currently

Present Law

In general, uniform cost capitalization rules apply to the production of property and to the purchasing and holding of property for resale. In the case of any plant or animal that is produced by a taxpayer in a farming business, the uniform capitalization rules apply only if (1) the plant or animal has a preproductive period of more than two years or (2) the taxpayer engaged in the farming business is a corporation, partnership or tax shelter that is required to use an accrual method of accounting.

Taxpayers engaged in a farming business may elect to deduct currently the costs relating to the production of farm products. If this election is made, gain from the disposition of the farm product is taxed as ordinary income to the extent of prior deductions that would have been capitalized and all farm assets placed in service in any taxable year for which an election is in effect are subject to the alternative depreciation system (which provides for straight-line cost recovery over a longer recovery period than generally applies).

The election to deduct currently preproductive period costs may not be made (1) by corporations, partnerships or tax shelters that are required to use an accrual method of accounting or (2) with respect to costs incurred in the planting, cultivation, maintenance, or development of pistachio trees.

Description of Proposal

Under the proposal, taxpayers who are not required to use an accrual method of accounting and who are engaged in the planting, cultivation, maintenance, or development of pistachio trees would be permitted to elect to deduct currently preproductive period costs. If this election is made, gain from the disposition of pistachio nuts would be taxed as ordinary income to the extent of prior deductions that would have been capitalized and all farm assets placed in service in any taxable year for which an election is in effect would be subject to the alternative depreciation system.

Effective Date

The provision would be effective as if included in the Tax Reform Act of 1986.

2. Treatment of certain pledged installment obligations

Present Law

The Revenue Act of 1987 provided special rules that apply to any installment obligation that arises out of the sale of non-farm real property that is used in a taxpayer's trade or business or that is held for the production of rental income where the selling price of the real property exceeds $150,000 (a "nondealer real property installment obligation"). Under these rules, if any indebtedness is secured directly by a nondealer real property installment obligation, the net proceeds of the secured indebtedness are treated as a payment on such installment obligation. This special rule generally applies to nondealer real property installment obligations that are pledged as security for a loan after December 17, 1987.

Description of Proposal

The special rule that treats the net proceeds of an indebtedness as payment on a nondealer real property installment obligation would not apply to a pledge of a nondealer real property installment obligation after December 17, 1987, to secure an indebtedness if the indebtedness is incurred to refinance indebtedness that (1) was outstanding on December 17, 1987, and (2) was secured by the nondealer real property installment obligation on such date and at all times thereafter until the refinancing occurred. This exception to the rule would not apply to the extent that the principal amount of the indebtedness resulting from the refinancing exceeds the principal amount of the refinanced indebtedness immediately before the refinancing. In addition, the exception would not apply to subsequent refinancings.

Effective Date

The provision would be effective as if included in the Revenue Act of 1987.

3. **Treatment of stock held in trust in determining whether certain corporations may use the cash method of accounting**

Present Law

Qualified personal service corporations are excepted from the general rule denying the use of the cash method of accounting to a C corporation or a partnership with a C corporation as a partner. A qualified personal service corporation is a corporation that satisfies both a function test and an ownership test. The ownership test is satisfied if substantially all (i.e., 95 percent) of the value of the outstanding stock is owned, directly or indirectly, by (1) employees performing services for the corporation in connection with the qualified services performed by the corporation, (2) retired employees who performed such services for the corporation, (3) the estate of any employee or retired employee, or (4) any other person who acquired stock by reason of the death of an employee or retired employee (for the two-year period beginning with the death of the employee or retired employee).

H.R. 4333, the technical corrections bill introduced on March 31, 1988, provides that, for purposes of determining whether a corporation satisfies the ownership test, indirect ownership of stock is taken into account only where stock is owned indirectly through one or more partnerships, S corporations, or qualified personal service corporations. Stock that is owned by a partnership, S corporation, or qualified personal service corporation is considered to be owned by its owners in the same proportion as their ownership of the partnership, S corporation, or qualified personal service corporation.

Description of Proposal

The Treasury Department would be required to issue regulations that provide to what extent stock owned by non-grantor trusts is to be treated as indirectly owned for purposes of determining whether the ownership test is satisfied.

Effective Date

The provision would be effective as if included in the Tax Reform Act of 1986.

G. Insurance Provisions

1. Repeal of general creditor requirement for certain personal injury liability assignments

Present Law

Under present law, an exclusion from gross income is provided for amounts received for agreeing to a qualified assignment to the extent that the amount received does not exceed the aggregate cost of any qualified funding asset, under a structured settlement arrangement.

A qualified assignment means any assignment of a liability to make periodic payments as damages on account of a personal injury or sickness (in a case involving physical injury or physical sickness), provided the terms of the assignment satisfy certain requirements. Generally, these requirements are that (1) the periodic payments are fixed as to amount and time; (2) the payments cannot be accelerated, deferred, increased or decreased by the recipient; (3) the assignee's obligation is no greater than that of the person assigning the liability; (4) the payments are excludable to the recipient as damages (under sec. 104(a)(2)); and finally, (5) the assignee does not provide to the recipient of such payments rights against the assignee which are greater than those of a general creditor.

Description of Proposal

A liability assignment would be treated as a qualified assigment notwithstanding that the recipient is provided creditor's rights against the assignee greater than those of a general creditor. No amount would be currently includible in the recipient's income as a result of providing to the recipient creditor's rights that are greater than the rights of a general creditor.

Reasons for Change

Recipients of periodic payments under structured settlements should not have their nontax rights as creditors limited by provisions of tax law.

Effective Date

The provision would apply to liability assignments made after the date of enactment.

2. Treatment of certain workers' compensation funds

Present Law

Self-insured workers' compensation funds generally are treated as mutual property and casualty insurance companies for Federal income tax purposes. In determining the taxable income of a property and casualty insurance company, a deduction is allowed for dividends and similar distributions paid or declared to policyholders in their capacity as such. In recent audits, the Internal Revenue Service has asserted that dividends declared by a workers' compensation fund are not deductible for the year declared if the amount of the declared dividend is subject to approval by a State regulatory authority in a later taxable year.

The Tax Reform Act of 1986 imposed a moratorium on audits and litigation relating to workers' compensation funds. This moratorium expired on August 16, 1987.

Description of Proposal

For taxable years beginning before January 1, 1987, qualified workers' compensation funds would be provided relief from deficiency assessments relating to the timing of the deduction for policyholder dividends. Further, the proposal clarifies that dividends declared by a workers' compensation fund are not deductible for the year declared if the amount of the declared dividend is subject to approval by a State regulatory authority in a later taxable year.

Reasons for Change

The proper taxable year for which policyholder dividends of self-insured workers' compensation funds are deductible is unclear under present law. For this reason, it is appropriate to clarify the timing of the deduction of such dividends for future years and to provide relief from deficiency assessments for past years.

Effective Date

The proposal would be effective on the date of enactment.

3. Church self-insured death benefit plans treated as life insurance

Present Law

Definition of a life insurance contract

Under present law, a life insurance contract is defined as any contract which is a life insurance contract under the applicable State or foreign law, but only if the contract meets either of two alternative requirements: (1) a cash value accumulation test or (2) a test consisting of a guideline premium requirement and a cash value corridor requirement.

If a life insurance contract does not meet either of the alternative tests under the definition of a life insurance contract, the income on the contract for any taxable year of the policyholder will be treated as ordinary income received or accrued by the policyholder during that year.

Exclusion for death benefits

Present law generally excludes from a beneficiary's gross income proceeds of death benefits received under a life insurance contract (sec. 101(a)) and provides a limited exclusion for other benefits paid by or on behalf of an employer by reason of an employee's death (sec. 101(b)).

Exclusion for group-term life insurance

Under present law, the cost of group-term life insurance purchased by an employer for an employee for a taxable year is included in the employee's gross income to the extent that the cost is greater than the sum of the cost for $50,000 of life insurance plus any contribution made by an employee to the cost of the insurance (sec. 79). The exclusion is conditioned on the satisfaction of certain nondiscrimination requirements.

Under present law, a group-term life insurance contract is required to meet the following conditions: (1) the contract is to provide a general death benefit that is excludable under section 101(a); (2) the contract is provided to a group of employees; (3) the policy is provided directly or indirectly by the employer; and (4) the amount of insurance protection provided to each employee is computed under a formula that precludes individual selection. Further, a group-term life insurance contract may not provide a permanent benefit (such as a cash surrender value).

Description of Proposal

Under the proposal, for purposes of sections 101(a) and

79, the term "life insurance contracts" generally would include certain church self-funded death benefit arrangements, even if the arrangements do not constitute life insurance under applicable State law. Thus, the section 101(a) exclusion would apply to a plan or arrangement that provides for the payment of benefits by reason of the death of the individuals covered under such plan or arrangement, but only if the plan or arrangement (1) is provided directly by a church for the benefit of its employees and their beneficiaries, by a church plan (as defined in sec. 414(e)(3)(A)), or by a church-controlled organization (within the meaning of sec. 414(e)(3)(B)(ii)); and (2) satisfies the requirements relating to the definition of a life insurance contract (sec. 7702) other than the requirement that the plan or arrangement be a life insurance contract under the applicable law.

In addition, under the proposal, the cost of such a life insurance contract would be includible in gross income except to the extent that the cost would be excludable under section 79 as group-term life insurance.

The proposal would define the term "church" to mean a church or a convention or association of churches. The term "employee" would have the same meaning as for purposes of the rules relating to church pension plans (sec. 414(e)(3)(B)).

Reasons for Change

The modifications made in the definition of life insurance in the Deficit Reduction Act of 1984 called into question the income tax exclusion for death benefits that some churches provide for their ministers and lay workers. Many of the church death benefit programs are funded through church pension boards, rather than through the purchase of commercial life insurance contracts.

The exclusion for death benefits should be retained in the case of a self-insured church death benefit program as long as the applicable requirements relating to the definition of a life insurance contract are satisfied, other than the requirement that may apply under some applicable State law that the contract must be issued by an insurance company licensed to do business under the laws of the State. Further, such life insurance programs also should be eligible for the exclusion for group-term life insurance as long as the requirements of section 79 are satisfied.

Effective Date

The provision would be effective as if included in the Deficit Reduction Act of 1984.

H. Pension Provisions

1. Limitations on contributions and benefits under qualified plans maintained by public employers

Present Law

The limit on the annual benefit provided by a defined benefit pension plan is generally the lesser of (1) 100 percent of average compensation or (2) $90,000. Prior to the Tax Equity and Fiscal Responsibility Act of 1982, the limit was the lesser of (1) 100 percent of average compensation or (2) $136,425. The Tax Reform Act imposed certain additional requirements relating to actuarial adjustments for early retirement benefits under defined benefit plans by repealing a $75,000 safe harbor for benefits commencing at or after age 55. Thus, under the Act, the actuarial adjustments to the limits on benefits are to be based on a $90,000 limit for benefits commencing at normal retirement age, rather than a $75,000 limit for benefits commencing at age 55. Plans maintained by public employers are not subject to the elimination of the $75,000 safe harbor for benefits commencing at or after age 55.

Description of Proposal

Under the proposal, a public employer is not treated as violating the limits on annual benefits if the benefits paid to an employee do not exceed the greater of (1) the usual limits on annual benefits or (2) the accrued benefit of an employee who became a plan participant before January 1, 1989, determined without regard to any benefit increases in plan amendments adopted after October 14, 1987. This special rule would apply only if the employer elects to apply the rules of present law relating to limits on annual benefits without regard to the special rules of present law applicable to public plans. This election would apply to all plans maintained by the public employer.

Reasons for Change

In several States, the courts have held that the benefit formula of a public plan may not be amended in any way that would reduce the ultimate benefit that a participant would receive under the formula in effect when the participant first became covered under the plan. Consequently, until public plans in those States are amended to incorporate the limits on annual benefits by reference (which is permitted under the Tax Reform Act), the plans must pay promised benefits to employees, even if the benefits violate the present-law limits on annual benefits. It is appropriate to provide time to the States in question to take legislative action to incorporate the limits by reference and to eliminate the risk of plan disqualification for the payment

of benefits in excess of the present-law limits to certain employees.

Effective Date

The proposal would be effective with respect to years beginning after December 31, 1982.

2. Grandfather certain public retirement plans from the minimum participation rule

Present Law

Under the Tax Reform Act of 1986, a plan is not a qualified plan unless it benefits no fewer than the lesser of (1) 50 employees, or (2) 40 percent of all employees of the employer.

Description of Proposal

Under the proposal, the minimum participation rule would not apply to any governmental plan with respect to employees who were participants in the plan on July 13, 1988.

Reasons for Change

Certain employees of public employers, such as city managers, often do not remain with one employer long enough to vest under the employer's regular retirement plan. Accordingly, many of these employees have made elections under State or local law not to participate in the employer's general retirement plan and to participate in plans that do not meet the minimum participation rule. It is often difficult to amend public employer pension plans because action by a legislative body is required. Therefore, a grandfather rule is appropriate to preserve the retirement benefits of individuals who are already covered under such plans.

Effective Date

The provision would be effective as if included in the Tax Reform Act of 1986.

3. Age 70-1/2 required beginning date not extended to public employees

Present Law

Present law provides (1) a required beginning date for distribution of benefits under all qualified plans (secs. 401(a) and 403(a)), individual retirement arrangements (IRAs), tax-sheltered annuities and custodial accounts (sec. 403(b)), and eligible deferred compensation plans of State and local governments and tax-exempt employers (sec. 457 plans); and (2) an excise tax sanction for failure to satisfy the minimum distribution rules that applies in lieu of plan disqualification. Under present law, the required beginning date is April 1 of the calendar year following the calendar year in which the participant or owner attains age 70-1/2, without regard to the actual date of separation from service.

Description of Proposal

The amendment would provide that, in the case of a governmental plan, the required beginning date is the later of (1) the required beginning date under the normal rule or (2) April 1 of the calendar year following the calendar year in which the employee retires.

Reasons for Change

Relief from the required beginning date for employees of public employers is appropriate due to the higher level of public scrutiny to which such employers are subject. Specifically, with respect to the required beginning date for retirement plans, the public may view as inappropriate the simultaneous payment by a public employer to an employee of both retirement benefits and current compensation. Therefore, it is appropriate to allow public employers to defer commencement of retirement benefits to an employee until after the employee separates from service.

Effective Date

The provision would be effective as if included in the Tax Reform Act of 1986.

4. Section 401(k) plans available to employees of rural telephone cooperatives

Present Law

Under present law, State and local governments and other tax-exempt organizations (other than rural electric cooperatives) may not maintain section 401(k) plans. Certain State or local governments and other tax-exempt organizations may maintain tax-sheltered annuity contracts (sec. 403(b)) under which employees may make tax-favored elective deferrals.

The rule prohibiting tax-exempt organizations from maintaining section 401(k) plans generally does not apply to a plan adopted by an organization before July 2, 1986.

Description of Proposal

Under the proposal, rural telephone cooperatives would be permitted to maintain section 401(k) plans.

Reasons for Change

Rural telephone cooperatives should be entitled to maintain section 401(k) plans on the same basis as rural elective cooperatives because such organizations operate in essentially the same manner.

Effective Date

The proposal would be effective for years beginning after the date of enactment.

5. Section 403(b) nondiscrimination requirements and other pension provisions

Present Law

Under present law (as amended by the Tax Reform Act of 1986), the qualified plan coverage and nondiscrimination rules are applicable to contributions to tax-sheltered annuity programs (sec. 403(b)) that are not made pursuant to a salary reduction agreement. In addition, contributions to a tax-sheltered annuity program that are made pursuant to a salary reduction agreement are required to satisfy a special nondiscrimination rule. This special rule is satisfied if all employees have the opportunity to make elective deferrals (subject to minimum contribution requirements.) These nondiscrimination rules do not apply to programs maintained for church employees.

The nondiscrimination requirements are effective for plan years beginning after December 31, 1988. (H.R. 4333 would delay the effective date for certain collectively bargained plans.) Under the 1986 Act, final Treasury regulations relating to these requirements, as well as numerous other pension provisions of the 1986 Act, were to be issued by February 1, 1988. As of July 1, 1988, no final regulations have been published on the nondiscrimination requirements or the other pension provisions.

Description of Proposal

In the absence of rules on which employers may rely, employers would be permitted to make reasonable interpretations of the section 403(b) nondiscrimination requirements based on the statute and its legislative history, as long as those interpretations are made in good faith. Such reasonable interpretations could be made for any issue relating to such nondiscrimination requirements, including the definition of the employer to which the requirements apply.

This reasonable interpretation standard would remain in effect until the later of the first plan year beginning (1) after December 31, 1990, or (2) at least six months following the issuance of rules on which a taxpayer may rely (e.g., temporary or final regulations, or proposed regulations if taxpayers may rely on them).

Under the amendment, the Secretary also would be directed to expedite all rules that were required by February 1, 1988. Pending the issuance of such rules with respect to the provisions other than the section 403(b) nondiscrimination requirements, employers would be permitted to make reasonable interpretations of the statute and legislative history, as long as those interpretations are

made in good faith.

Reasons for Change

In the absence of Treasury rules relating to certain pension provisions, it is appropriate to permit good faith interpretation of the provisions. In addition, with respect to the section 403(b) nondiscrimination rules, taxpayers should be allowed to rely on such interpretations for a minimum period of time to reduce uncertainty and the administrative burdens of multiple plan changes in a short period of time.

Effective Date

The provision would be effective as if included in the Tax Reform Act of 1986.

I. Foreign Provisions

1. Dual resident companies

Present Law

Under the 1986 Act, a loss of a U.S. corporation that is subject to income tax in a foreign country on its income without regard to its source or on a residence basis cannot reduce the taxable income for any taxable year of any other member of its affiliated group. In 1987, the United Kingdom enacted similar legislation. Therefore, for a U.S. corporation that also is a U.K. resident to share a loss with, for example, a U.K. affiliate, the corporation must give up its status as a U.S. corporation.

Losses derived by and distributions from a U.S. corporation that is a member of a U.S. consolidated group reduce its parent's basis in its stock. Losses and distributions in excess of that basis create an "excess loss account" that must be recaptured by the parent if, among other things, it disposes of its U.S. subsidiary's stock.

Description of Proposal

The proposal would allow a U.S. corporation that has an excess loss account with respect to its stock which arose prior to January 1, 1988 and while the corporation was also a U.K. resident to reorganize as a new U.K. corporation without the recapture of its excess loss account by its parent on the disposition of the U.S. corporation's stock. Instead, the excess loss account would be suspended until the stock in the new U.K. corporation is disposed of outside of the affiliated group. In addition, rules would be provided so that the new U.K. corporation's income is subject to full U.S. tax jurisdiction until the excess loss account is reduced to zero or is otherwise recaptured.

Reasons for Change

It is appropriate to provide U.S. multinationals reasonable opportunities to unwind corporate structures prohibited by the 1986 Act while continuing to provide proper incentives to minimize foreign taxes.

Effective Date

The provision would be effective for reorganizations occurring after date of enactment.

2. Gambling winnings of nonresident aliens

Present Law

A 30 percent withholding tax is imposed on certain U.S. source income of nonresident aliens, including interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income. Subject to exceptions, the IRS collects this tax on gambling winnings of nonresident aliens from slot machines, keno, parimutuel games, bingo, and pull-tab games. However, the Service has found it administratively infeasible to collect the tax on winnings from "table games" played at casinos (which include blackjack, roulette, baccarat, and craps) without disruption to the gaming industry. Consequently, no 30 percent withholding tax is currently collected on table game winnings of nonresident aliens.

Description of Proposal

The proposal would codify the current IRS practice of not collecting the 30 percent withholding tax on U.S. gambling winnings of nonresident aliens from blackjack, roulette, baccarat, and craps. However, the proposal would enable the Service to collect the tax on winnings from those games if, as a result of future changes in the conduct of the games or payment of winnings, the Treasury determines that such collections have become administratively feasible without risrupting the gaming industry. Other U.S. gambling winnings of nonresident aliens would continue to be subject to 30 percent withholding tax as under present law.

Reasons for Change

The proposal would rationalize the administration of the 30 percent withholding tax rules on income of nonresident aliens.

Effective Date

The proposal would be effective for winnings on or after date of enactment.

3. Election to be a qualified electing fund in a passive foreign investment company (PFIC)

Present Law

The election to treat a passive foreign investment company (PFIC) as a qualified electing fund can be made only by the PFIC. To make the election, the PFIC must agree to such requirements as are prescribed by regulation that determine the income of the company, the ownership of the company's outstanding stock, and other information necessary to carry out the purposes of the PFIC provisions.

Qualified electing fund status is important in determining whether any gain derived by (and, in some cases, distributions received by) U.S. investors is subject to deferred tax and interest. For example, a U.S. investor in a PFIC that has been a qualified electing fund for all of the years beginning after 1986 in which the company was a PFIC, and that include any portion of the investor's holding period, can dispose of his or her investment without the gain being subject to deferred tax and interest. A U.S. investor in a PFIC who has held stock during years in which the company was not a qualified electing fund generally is subject to deferred tax and interest on his or her gain, however.

Description of Proposal

The election to be a qualified electing fund would be made at the U.S. shareholder level, rather than at the company level. The shareholder election would be available, however, only where the PFIC complied with appropriate requirements (as prescribed by regulation) to determine the income of the company and other information necessary to carry out the PFIC provisions.

Reasons for Change

The proposal, by relieving PFICs from the stock ownership notification requirements imposed under the Act, should allow more U.S. investors in PFICs to avail themselves of the qualified electing fund rules.

Effective Date

The provision would be effective as if included in the 1986 Act.

4. Foreign currency transactions

Present Law

The 1986 Reform Act provided uniform residence-based sourcing and ordinary income and loss characterization rules (Code sec. 988) for certain gains and losses on foreign currency-related forward contracts, futures contracts, options, and similar financial instruments. These source and character rules do not apply if the instrument is marked to market under section 1256 at year-end. Nor are these rules intended to apply if the instrument would have been marked to market if held at year-end. The source and character of any gains or losses on such an instrument are determined under general Code rules.

Description of Proposal

Income and loss on foreign currency-related forwards, futures, options, and similar instruments would be sourced on a residence basis and treated as ordinary income or loss, without regard to whether the instruments are or would be marked to market under section 1256.

Reasons for Change

Repeal of the exclusion from section 988 source and characterization rules for income and losses on section 1256 marked-to-market instruments would eliminate unnecessary complexity for taxpayers and the IRS.

Effective Date

The provision would be effective for instruments entered into or acquired after the date of committee action.

5. Debt-equity ratio of Netherlands Antilles finance subsidiaries

Present Law

In the Tax Reform Act of 1984, Congress generally repealed the withholding tax on U.S. source interest paid to foreign persons for interest paid on obligations issued after July 18, 1984. As part of that Act, Congress grandfathered interest on certain debt of U.S. corporations owed to certain controlled foreign corporations organized in the Netherlands Antilles, which in turn had issued debt to foreign persons. The grandfather was necessary to prevent the interest paid by U.S. corporations to their controlled foreign corporations from being considered paid to the ultimate holders of the debt, the foreign persons, and thus, to prevent the interest from being subject to the withholding tax.

Controlled foreign corporations that qualified for the above treatment had to meet certain requirements based upon the principles of four revenue rulings (issued in connection with the since-repealed Interest Equalization Tax: Rev. Rul. 69-377, 69-2 C.B. 231; Rev. Rul. 69-501, 69-2 C.B. 233; Rev. Rul. 70-645, 70-2 C.B. 273; and Rev. Rul. 73-110, 73-1 C.B. 454). These principles include, among other things, the maintenance of a specified debt-equity ratio, which generally is interpreted to mean no more than 5-to-1.

Description of Proposal

The proposal would allow a U.S. parent to increase its debt-equity ratio in its Netherlands Antilles subsidiary to 25-to-1 without violating the provisions of the 1984 Act's grandfather.

Reasons for Change

The proposal would allow a U.S. multinational to repatriate some of its capital in its Netherlands Antilles subsidiary so that that capital could be used in the multinational's active business operations.

Effective Date

The proposal would be effective for taxable years ending after date of enactment.

6. Treatment of foreign insurance branch as controlled foreign corporation

Present Law

The 1986 Act repealed deferral for (that is, imposed current tax on) insurance income derived by controlled foreign corporations. The Act preserved deferral for underwriting income attributable to risks of property or activities in, or the lives or health of residents of, the country in which the controlled foreign corporation is organized.

Description of Proposal

The proposal would treat a foreign branch of a controlled foreign corporation as a separate corporation for purposes of applying the same-country exception to insurance income derived by controlled foreign corporations. Rules would be provided to treat remittances by the branch as a dividend for purposes of imposing current tax on repatriated earnings.

Reasons for Change

The foreign branch of a controlled foreign insurance company, engaged in local insurance business in the branch country, does not necessarily earn tax haven insurance income on which U.S. tax should be imposed currently if the income derived by the branch is retained in its country of operation.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1988.

J. Tax-Exempt Bonds

1. Clarification of definition of manufacturing for qualified small-issue bonds

Present Law

Interest on State and local government bonds generally is tax-exempt. Interest on private activity bonds issued by governments is taxable unless a specific exemption is provided in the Code. One exemption provided is for qualified small-issue bonds. Qualified small-issue bonds may be issued for manufacturing facilities only; authority to issue these bonds is scheduled to expire after December 31, 1989.

A manufacturing facility is defined as a facility for the production of tangible personal property. The fact that a de minimis amount of the space in a manufacturing plant is devoted to offices directly related to the manufacturing process conducted in the plant may be disregarded. However, a separate office wing of a larger, mixed-use building is treated as a nonmanufacturing facility.

Description of Proposal

The proposal would clarify that the definition of manufacturing does not preclude the use of a portion of the proceeds of an issue of qualified small-issue bonds to finance ancillary activities provided those activities meet several criteria and provided at least 75 percent of the proceeds of the issue are used to finance the core manufacturing (i.e., production) facility itself.

All ancillary facilities financed with the bonds would be required to be located at the same site as the core manufacturing facility; manufacturing must constitute substantially all of the on-site economic activity; and all other activities must be subordinate to and integral to the manufacturing process. Where a distinct and separate economic activity is performed at a single physical location where manufacturing takes place (e.g., an activity, such as warehousing), the facilities for the activity would be treated as a separate establishment and not part of the manufacturing facility whenever the employment in each such economic activity was significant.

Reasons for Change

Several issuers have indicated they are unclear as to the types of facilities that come within the scope of a manufacturing facility. As a result, many legitimate bond issuances are being hindered. The proposal would clarify the ambiguity in present law.

Effective Date

This proposal would apply to bonds issued after the date of the bill's enactment.

2. Other clarifications

a. Extension of minimum period for calculating TRAN safe-harbor compliance

Present Law

Arbitrage earnings from investment of tax and revenue anticipation note (TRAN) proceeds must be rebated to the Federal Government under the same rules as apply to other tax-exempt bonds. A special safe-harbor calculation is provided, however, for determining whether TRAN issues are exempt from rebate under a general exception for tax-exempt bond issues the gross proceeds of which are spent for the governmental purpose of the borrowing within six months after the bonds are issued. Under this safe harbor, TRAN net proceeds are treated as so spent if the issuer's cumulative cash flow deficit for the period beginning on the date the notes are issued and ending on the earliest of (a) the maturity date of the TRANs, (b) six months after the TRANs are issued, or (c) the actual date the cash flow deficit exceeds 90 percent of the TRAN proceeds. Final rebate payments for bond issues are due 60 days after the bonds are redeemed.

Description of Proposal

The proposal would extend the period for determining whether the TRAN safe harbor was satisfied to six months for TRAN issues having maturities of less than six months. The final rebate payment on such issues would be due eight months after the date of issue.

Effective Date

The proposal would apply to TRANs issued after the date of the bill's enactment.

b. Clarification of Treasury Department arbitrage rebate regulatory authority with respect to governmental bonds

Present Law

Issuers of tax-exempt bonds are required to rebate to the Federal Government arbitrage earnings on investments unrelated to the governmental purpose of the borrowing. The Treasury Department currently is drafting regulations interpreting and providing administrative guidance on this requirement.

Description of Proposal

Clarification would be provided in the committee report that Treasury is to have as a primary objective in promulgating arbitrage rebate regulations for governmental bonds the adoption of regulations that are workable and understandable to the governmental units that must comply with them. Clarification further would be provided that Treasury is authorized to create safe harbors for calculating rebate payments with respect to governmental bonds in cases where it determines that the safe harbors will encourage prompt expenditure of bond proceeds and, without encouraging issuance of bonds followed by investment of proceeds in higher yielding investments, will reduce administrative burdens on State and local governments.

Effective Date

The proposal would be effective as if included in the Tax Reform Act of 1986.

c. Application of arbitrage rebate requirement to bona fide debt service funds

Present Law

Issuers of tax-exempt bonds are required to rebate to the Federal Government arbitrage earnings on investments unrelated to the governmental purpose of the borrowing. No rebate is required with respect to an issue if the gross proceeds of the issue are spent for the governmental purpose of the borrowing within six months after the bonds are issued. At the election of the issuer, amounts invested in a bona fide debt service fund (i.e., a fund to satisfy current debt service on the bonds) are exempt from the rebate requirement if the gross earnings on the fund are less than $100,000.

Description of Proposal

The proposal would amend the rebate exemption for bona fide debt service funds in two respects. First, the $100,000 earnings limit would not apply to governmental bonds having a weighted average maturity of five years or more and bearing interest at rate that does not vary over the term of the bonds. Second, the exclusion from rebate would be mandatory for all bond issues.

Effective Date

The proposal would apply to bonds issued after the date of the bill's enactment.

3. Certain volunteer fire departments qualify for tax-exempt financing

Present Law

Tax-exempt bonds may be issued to finance firehouses and firetrucks for volunteer fire departments if the fire departments are the only organization providing firefighting services to the jurisdiction which they serve and if they are required by written agreement with the governmental unit to provide such services. The Internal Revenue Service has stated that its ruling position is that land ancillary to a firehouse may not be financed with tax-exempt bonds.

Description of Proposal

The proposal would exempt from the requirement that a volunteer fire department be the exclusive provider of firefighting services in it service area, volunteer fire departments that qualify for tax-exempt financing except for the fact that, since January 1, 1981, the governmental unit being served has continuously and exclusively been served by more than one volunteer fire department.

The proposal also would clarify that reasonable amounts of land ancillary to a firehouse qualifying for tax-exempt financing may be financed as part of the acquisition or construction of the firehouse.

Effective Date

The proposal would apply to bonds issued after the date of the bill's enactment.

K. Low-Income Rental Housing Credit

1. Local government exactions on developers of credit projects

Present Law

A credit having a 70-percent (30-percent on federally subsidized and existing housing) present value is available to owners of low-income rental housing. Some governmental units require developers of real property other than low-income rental housing to provide low-income housing as a condition of receiving favorable zoning variances with respect to the non-low-income-housing property. The effect of these "exactions" on qualification for the low-income housing credit is unclear under present law.

Description of Proposal

The proposal would clarify that a requirement by a local government that a developer build low-income rental housing as a condition of receiving favorable zoning variances on other real property does not affect qualification of the low-income housing for the tax credit.

Effective Date

The proposal would be effective as if included in the Tax Reform Act of 1986.

2. Certain reductions in family size not to affect rent that may be charged to low-income tenants

Present Law

A credit having a 70-percent (30-percent on federally subsidized and existing housing) present value is available to owners of low-income rental housing. Rents charged to tenants living in housing units on which the credit is claimed may not exceed 30 percent of the income qualifying as "low," adjusted for family size.

Description of Proposal

The proposal would provide that changes in family size occurring as a result of death, divorce, separation, or abandonment are disregarded in determining the gross rent that may be charged to an existing low-income tenant in a credit project.

Effective Date

The proposal would apply to low-income rental housing property placed in service after December 31, 1988.

3. Repeal limit on corporate ownership in certain partnerships owning low-income rental housing credit projects

Present Law

A credit having a 70-percent (30-percent on federally subsidized and existing housing) present value is available to owners of low-income rental housing. If property on which a credit is claimed ceases to qualify as low-income rental housing or is disposed of before the end of a 15-year compliance period, a portion of the credit may be recaptured. In the case of a disposition, recapture generally is determined at the level of each owner of the property. In the case of partnerships having 35 or more partners (with no more than 50 percent of the partnership interests being held by corporations), recapture may, if the partnership elects, be determined at the partnership level.

Description of Proposal

The proposal would delete the limit on corporate ownership for partnerships comprised at all times of 35 or more partners; thus, recapture for these partnerships would be determined at the partnership, rather than the partner, level. Additionally, the proposal would provide that the special recapture rule applies to qualifying partnerships unless the partnerships elect otherwise.

Effective Date

The proposal would be effective as if included in the Tax Reform Act of 1986. A special rule would permit partnerships that place property in service before the date of the bill's enactment to change previously made decisions on applicability of the partnership recapture rule within 90 days after enactment.

L. Estate and Gift Tax

1. Special use valuation of farm property for estate tax purposes

Present Law

If the executor so elects, the value of qualified real property is its value in the use under which it qualifies as qualified real property. Qualified real property must be used for a qualified use, which is a use as a farm for farming purposes or in another trade or business, and an additional tax is imposed if it ceases to be used for its qualified use within 10 years (15 years for individuals dying before 1982) after the death of the individual in whose estate it is specially valued. Cash rental of specially valued property is not a qualified use and, therefore, is treated as a recapture event.

Description of Proposal

A surviving spouse's cash rental of specially valued real property to qualified heirs would not result in the property failing to be treated as still used in a qualified use for purposes of the current use valuation recapture tax.

Reasons for Change

The proposal allows surviving spouses to obtain a more certain income stream than would be provided by a crop share lease.

Effective Date

The proposal would be effective for recapture events occurring after the date of enactment.

M. Compliance

1. Disclosure of return information to certain cities

Present Law

Section 6103 provides for the confidentiality of returns and return information of taxpayers. The conditions under which returns and return information can be disclosed are specifically enumerated in that section. Disclosure of returns and return information to local income tax administrators generally is not permitted. However, a specific exception to this rule provides that any city with a population in excess of 2 million that imposes an income (or wage) tax may, if the Secretary in his sole discretion so provides, receive returns and return information for the same purposes for which States may obtain information, subject to the same safeguards as apply to States.

Description of Proposal

The Proposal would provide that the Secretary may disclose returns and return information to local tax administrators in cities with a population in excess of 250,000 (rather than the present-law requirement of a population in excess of 2 million) that impose a tax on income or wages. The various safeguards and conditions governing disclosure of returns and return information to local tax administrators would remain unchanged.

Effective Date

This provision would be effective on the date of enactment.

N. Excise Taxes

1. Certain tolerances permitted in determination of wine tax

Present Law

An excise tax ranging from $0.17 cents per wine gallon (14 percent or less alcohol) to $3.40 per wine gallon (champagne) is imposed on wine.

Description of Proposal

The Treasury Department would be authorized to prescribe *de minimis* tolerances for the amount of wine contained in commercial containers. If the amount of wine in a container was within these tolerances, tax would not be collected for any excess wine actually in the container.

Effective Date

The proposal would be effective on January 1, 1989.

2. Gasoline wholesalers permitted to claim refunds on behalf of certain exempt users

Present Law

The gasoline excise tax is imposed on removal of gasoline blend stocks from the refinery or a bonded pipeline terminal. Exemptions from tax are provided for, inter alia, fuels that are exported, sold for use as supplies for vessels or aircraft, for use by States and local governments, and for use by certain nonprofit educational organizations. These exemptions generally are realized by means of refunds to the ultimate users; however, present law allows refiners and terminal operators (as taxpayers) to claim the refunds on behalf of the cited persons provided the refiners or terminal operators can prove they pass the benefit of tax exemption through to the ultimate exempt user.

Description of Proposal

The proposal would allow wholesale distributors (defined as under the diesel fuel excise tax provisions) instead of refiners to claim refunds of gasoline tax for exempt users on the same basis as refiners and terminal operators may do under present law. Wholesale distributors would be the only persons entitled to claim these refunds when they purchase gasoline tax-paid. The proposal would not change the point at which the gasoline tax is collected or the party who remits that tax.

Effective Date

The proposal would apply to gasoline sold by wholesale distributors after September 30, 1988.

3. Exemption from harbor maintenance tax for cargo donated for humanitarian purposes

Present Law

The Water Resources Development Act of 1986 (P.L. 99-662) established a new harbor maintenance user tax of 0.04 percent of the value of the commercial cargo loaded or unloaded at a United States port (sec. 4461), effective on April 1, 1987. Commercial cargo is defined as any cargo transported on a commercial vessel, including passengers transported for compensation or hire.

Under regulations issued by the U.S. Customs Service, the user tax is assessed on any cargo loaded or unloaded at a U.S. port, unless otherwise exempted. No exception is made in the statute or in the regulations for cargo, usually food, clothing or medical supplies, which is to be donated overseas for humanitarian or developmental reasons.

Description of Proposal

The proposal would exclude from the harbor maintenance tax cargo that is donated for humanitarian and development assistance overseas, where such cargo is owned or financed by a non-profit organization or cooperative and where the Customs Service certifies that the cargo is, in fact, intended for donation overseas.

Reasons for Change

Applying the harbor maintenance user tax to cargo that is intended for donation overseas for humanitarian or developmental purposes is inconsistent with the general thrust of the Internal Revenue Code to generally exempt charitable and humanitarian activities from taxation.

Effective Date

The provision would be effective on April 1, 1987 (the effective date of the tax).

4. Exemption from certain excise taxes where benefit accrues to United States

Present Law

The Treasury Department has the authority to exempt from manufacturers' excise taxes articles that are sold to the United States where it is demonstrated that the benefit of the exemption will accrue to the Federal Government.

Description of Proposal

The retail excise tax on heavy trucks would be added to the category of excise taxes for which the Treasury Department can provide exemptions if the benefit accrues to the Federal Government.

Effective Date

The proposal would apply to sales occurring after the date of the bill's enactment.

5. Allow quarterly payment of excise tax on bows and arrows

Present Law

An 11-percent manufacturers' excise tax is imposed on certain bows and arrows. This excise tax, like other Federal excise taxes, generally is required to be deposited with regard to semi-monthly periods. Excise tax returns are required to be filed on a quarterly basis.

Description of Proposal

Persons liable for payment of the excise tax on bows and arrows would be excused from semi-monthly deposit requirments; thus, the tax would be paid when regular quarterly excise tax returns are required to be filed.

Effective Date

The proposal would be effective for taxable events occurring after December 31, 1988.

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July 13, 1988
4:00 p.m.

O. Miscellaneous Provisions

1. Repeal of Treasury long-term bond authority

Present Law

The Secretary of Treasury is allowed to issue up to $270 billion in bonds (obligations that mature more than 10 years after issue date) with interest rates above the 4 1/4 percent statutory limit. Bonds held by the general public are subject to the limitation; bonds held in Federal Government agency and Federal Reserve accounts are not included in the limit.

The last prior increase in the exception, from $250 billion to $270 billion, was enacted in the Omnibus Budget Reconciliation Act of 1987. An exception to the statutory limit was enacted initially in 1971 and applied only to bonds held by the general public in 1973.

Description of Proposal

The statutory limitation would be repealed.

Effective Date

This provision would be effective upon the date of enactment.

2. Discharge of indebtedness income of mutual or cooperative telephone, water or electric companies

Present Law

Federal income tax rules

Under present law, a mutual or cooperative telephone, electric or water company qualifies for exemption from Federal income taxation if at least 85 percent of its gross income consists of amounts collected from members for the sole purpose of meeting losses and expenses of providing service to its members. In the case of mutual or cooperative telephone or electric companies, the 85-percent test is determined without regard to income from certain qualified pole rentals. In the case of mutual or cooperative telephone companies, the 85-percent test is determined without regard to income from certain long-distance fees and telephone directory income. Code sec. 501(c)(12).

Gross income of a taxpayer generally includes income from discharge of indebtedness. Sec. 61(12).

Sale of debt obligations of cooperative water companies under the Omnibus Budget Reconciliation Act of 1986 (OBRA)

Section 1001 of the Omnibus Budget Reconciliation Act (OBRA) of 1986 required the Secretary of Agriculture to sell sufficient notes and other obligations of cooperative water companies that were held in the Rural Development Fund to realize specified dollar amounts of proceeds for fiscal years 1987, 1988, and 1989. The Continuting Appropriations Act of 1987 (P.L. 100-233) grants to the obligor of a debt obligation to be sold by the Secretary of Agriculture a right of first refusal to acquire such obligation at a discounted price.

Prepayment of debt obligations of cooperative electric companies under OBRA

Section 1011 of the OBRA permits cooperative electric companies to prepay loans owed by them to the Federal Financing Bank and guaranteed by the Federal Government (under section 306 of the Rural Electrification Act of 1936) at a discount provided (1) the loan is outstanding on July 2, 1986, (2) the loan is replaced with private capital, and (3) the cooperative electric company either passes on any savings from the repayment to its customers or uses the savings to improve the financial strength of the cooperative.

Federal guarantee of debt of cooperative electric companies

Section 306 of the Rural Electrificiation Act of 1936

provides a Federal guarantee to certain loans made by the Federal Financing Bank to cooperative electric companies.

Description of Proposal

The 85-percent test of section 501(c)(12) would be determined without regard to any discharge of indebtedness income arising in 1987, 1988, or 1989 on debt that either originated with, or is guaranteed by, the Federal Government.

Reasons for Change

The fundamental purpose of the 85-percent test is to insure that the principal activity of the cooperative is its tax-exempt purpose of providing utility services to its members. The fundamental nature of a cooperative's activities does not change because it has discharge of indebtedness income, especially Federally-backed debt which was incurred as part of the cooperative's exempt activities. Limiting the relief to discharge of indebtedness arising in 1988 and 1989 will permit the sufficient sales of notes to meet the revenue targets of OBRA.

Effective Date

The provision would be effective for discharge of indebtedness income realized after December 31, 1986 and before January 1, 1990.

3. One-year extension of placed-in-service rule for nonconventional fuels credit

Present Law

Qualified fuels are eligible for the production credit for nonconventional, if the fuel is produced from a well drilled after December 31, 1979, and before January 1, 1990, or produced from a facility placed in service after December 31, 1979, and before January 1, 1990, and the fuel is sold after December 31, 1979, and before January 1, 2001.

Description of Proposal

Qualified fuels would be eligible for the production credit, if produced from a facility placed in service or a well drilled one-year later than the expiration date in present law, namely, a well drilled or a facility placed in service before January 1, 1990.

Reason for Change

Facilities may not be placed in service by December 31, 1989, for reasons over which the taxpayer may have no control, such as, changes in legislation governing regulatory procedures or environmental regulations.

Effective Date

This provision would become effective on the date of enactment.

4. Determination of operating foundation status for certain purposes

Present Law

Section 302 of the Deficit Reduction Act of 1984 (P.L. 98-369) provided an exemption from the section 4940 excise tax on the net investment income of a private foundation for certain operating foundations. The organizations that were exempted from the tax by that provision included any private foundation that constituted an operating foundation (as defined in sec. 4942(j)(3)) as of January 1, 1983 and that met certain other requirements. The 1984 Act also provided that grants from other foundations to such an operating foundation are not subject to the section 4945 expenditure responsibility requirements.

Description of Proposal

For purposes of section 302(c)(3) of the Deficit Reduction Act of 1984, a private foundation that constituted an operating foundation (as defined in sec. 4942(j)(3)) for its last taxable year ending before January 1, 1983 would be treated as constituting an operating foundation as of January 1, 1983.

Reasons for Change

In light of interpretive questions that have been raised concerning the determination period for operating foundation status with respect to the 1984 Act provision, it is appropriate to provide for this purpose that a foundation that constituted an operating foundation for its last taxable year ending before January 1, 1983 should be treated as constituting an operating foundation as of January 1, 1983.

Effective Date

The provision would be effective on enactment.

P. Items Requiring Only Report Language

1. Treatment of bankruptcy and insolvency restructurings under the minimum tax preference for adjusted current earnings

Present Law

Corporations are subject to an alternative minimum tax payable, in addition to all other tax liabilities, to the extent it exceeds the taxpayer's regular tax. The tax is imposed at a flat rate of 20 percent on alternative minimum taxable income in excess of an exemption amount. Alternative minimum taxable income generally is the taxpayer's taxable income, increased or decreased by certain adjustments and preferences.

For taxable years beginning after 1989, three-fourths of the excess of adjusted current earnings over other alternative minimum taxable income is a preference.

Description of Proposal

The proposal would state in Committee Report language that under current law the transfer of a corporation's own stock to a creditor in a Title 11 case (or to the extent the corporation is insolvent) does not give rise to adjusted current earnings where the stock for debt exception applies in computing taxable income.

Reasons for Change

It is desireable to clarify that, by reason of the current law stock for debt exception, a corporation that issues stock to its creditors in a bankruptcy case or to the extent insolvent does not have minimum taxable income under the adjusted current earnings preference.

Effective Date

The provision applies to taxable years beginning after December 31, 1989.

2. Treatment of organizations providing supplemental HMO-type services under Code Section 501(m)

Present Law

Under present law, an organization described in sections 501(c)(3) or (4) of the Code is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance (section 501(m)). In the case of such a tax-exempt organization, the activity of providing commercial-type insurance is treated as an unrelated trade or business, and is taxed under the rules relating to insurance companies (subchapter L of the Code).

With respect to the tax-exempt status of health maintenance organizations (HMOs) and similar organizations, the Ways and Means committee report to the 1986 Act provides:

> The Act is not intended to alter the tax-exempt status of an ordinary health maintenance organization that provides health care to its members predominantly at its own facility through the use of health care professionals and other workers employed by the organization. HMOs provide physician services in a variety of practice settings primarily through physicians who are either employees or partners of the HMO or through contracts with individual physicians or one or more groups of physicians (organized on a group practice or individual practice basis). Similarly, organizations that provide supplemental health maintenance organization-type services (such as dental services) would not be affected if they operate in the same manner as a health maintenance organization. [Emphasis supplied.]

The conference report to the 1986 Act states that it "does not alter the tax-exempt status of health maintenance organizations (HMOs)," and restates the second of the above 3 sentences from the House Report.

The conference report also adds, in the effective date of the provision adopting section 501(m), that the provision does not apply to dental benefit coverage provided by Delta Dental Plan organizations. The statutory language of this exclusion is corrected in the Technical Corrections bill (H.R. 4333).

Description of Proposal

The proposal would clarify that the language in the Ways and Means committee report for the 1986 Act was not overridden by the Statement of Managers to the conference report for that Act. The proposal would also clarify that dental and vision care is a type of supplemental HMO-type

service contemplated by the 1986 Act legislative history.

Reasons for Change

Because the Statement of Managers for the 1986 Act did not include the language from the Ways and Means committee report relating to supplemental HMO-type services, the tax-exempt status of certain organizations might be questioned. It is appropriate to clarify that the Ways and Means committee report language was not overridden by the Statement of Managers.

Effective Date

The provision would be effective as if included in the 1986 Act.

3. Early withdrawal tax inapplicable to annuity payments even if non-annuity benefit also payable

Present Law

Under present law, a 10-percent additional income tax applies to certain early withdrawals from qualified retirement plans. The early withdrawal tax does not apply in the case of a distribution to an employee that is part of a scheduled series of substantially equal periodic payments for the life or life expectancy of the participant (or the joint lives or life expectancies of the participant and the participant's beneficiary).

Description of Proposal

The proposal would clarify in legislative history the present-law rule that annuity payments to an employee that are otherwise not subject to the additional income tax on early withdrawals do not become subject to such tax merely because a separate non-annuity payment is made to the employee (e.g., a lump-sum early retirement incentive payment).

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1986.

4. Tip reporting

Present Law

Under present law, employers are required, under certain circumstances, to provide an information report of an allocation of tips in large food or beverage establishments (defined generally to include those establishments that normally employ more than 10 employees). Under this provision, if tipped employees of large food or beverage establishments report tips aggregating 8 percent or more of the gross receipts of the establishment, then no reporting of a tip allocation is required. However, if this 8-percent reporting threshold is not met, the employer must allocate (as tips for information reporting purposes) an amount equal to the difference between 8 percent of gross receipts and the aggregate amount reported by employees. This allocation may be made pursuant to an agreement between the employer and employees or, in the absence of such an agreement, according to Treasury regulations.

These Treasury regulations[1] provide that this allocation may be made by the employer in either of two ways. One is to allocate based on the portion of the gross receipts of the establishment attributable to the employee during a payroll period. The second is to allocate based on the portion of the total number of hours worked in the establishment attributable to the employee during a payroll period.

The method of tip allocation based on the number of hours worked may be utilized only by an establishment that employs less than the equivalent of 25 full-time employees during a payroll period. Establishments employing the equivalent of 25 or more full-time employees consequently have to use the portion of gross receipts method to allocate tips during the payroll period (absent an agreement between the employer and employees).

Explanation of Provision

Congress believed that the method of tip allocation based on the number of hours worked could unfairly allocate tips among employees, because the amount of tips is not spread evenly throughout all the hours an establishment is open for business. Consequently, this method may not be used by relatively sizeable establishments.

The committee is concerned that a number of sizeable establishments are evidently not observing this law. Congress provided that establishments with 25 or more full-time

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[1] See Treas. Reg. sec. 31.6053-3.

equivalent employees must use the more exact allocation method to minimize any unfairness to employees in the allocation of tips. The committee encourages these employers to be certain that they are observing the provisions of this law. If the committee finds that widespread abuse continues into the future, the committee may find it necessary either to further strengthen the allocation rules or to impose penalties on non-compliant employers.

Q. Studies

1. Study of investment-oriented life insurance and annuity products

Present Law

Under present law, the undistributed investment income ("inside buildup") earned on premiums credited under a life insurance contract generally is not subject to current taxation to the owner of the contract.

The committee bill would recharacterize life insurance contracts not satisfying a 7-pay model as modified endowment contracts subject to revised distribution rules similar to the present-law rules for deferred annuities.

Description of Proposal

The Treasury Department and the General Accounting Office (GAO) each would be directed to conduct studies (1) on the effectiveness of the revised tax treatment of life insurance and annuity products in preventing the sale of life insurance primarily for investment purposes, and (2) on the policy justification for, and the practical implications of, the present-law treatment of the earnings on the cash surrender value of life insurance and annuity contracts in light of the reforms made by the Tax Reform Act of 1986. The studies would be required to be submitted to the House Ways and Means Committee and the Senate Finance Committee by March 1, 1989.

Reasons for Change

Life insurance contracts currently are being marketed in a manner intended to attract investors into the life insurance market. Such marketing results in the purchase of life insurance products for noninsurance purposes and defeats the reason that favorable tax treatment was originally accorded to life insurance. It is appropriate to study the tax treatment of single premium and investment-oriented life insurance and annuity products to determine whether further legislative change is necessary.

Effective Date

The studies would be due by March 1, 1989.

2. Cigarette excise tax study

Present Law

Excise taxes are imposed on cigars, cigarettes, cigarette paper and tubes, and on snuff and chewing tobacco. The excise tax on small cigarettes is 16 cents per pack of 20 cigarettes. Most taxable cigarettes are small cigarettes.

Description of Proposal

The proposal would require an ongoing study by the Treasury Department, after consulting with the Surgeon General, of:

(1) the public and private health care costs incurred as a result of cigarette smoking in the United States;

(2) the incidence of cigarette smoking in the U.S. by teenage and younger children;

(3) the impact of the rate of the cigarette excise tax on smoking by teenage and younger children; and

(4) the impact of smoking on other, nonsmoking family members (e.g., spouses).

Reports of the results of the study would be required to be submitted every two years to the House Committee on Ways and Means and the Senate Committee on Finance, with the first such report to be submitted by April 1, 1989.

Effective Date

The proposal would be effective on the date of enactment.

3. Study of corporate dividends received deduction

Description of Proposal

The Treasury Department is directed to conduct a study of the dividends received deduction and provide any recommendations for legislative changes no later than 6 months following the date of enactment of this legislation.

The study is expected to address issues including the relationship of the dividends received deduction to issues of integration and the function of the deduction as a mechanism to relieve multiple corporate level taxation; as well as problems associated with the classification of instruments as debt or equity; the propriety of permitting a deduction if the payor corporation has not paid full tax at regular corporate rates on the distributed income; and the impact of the dividends received deduction on market behavior, including the potential for corporate holders to prefer dividends to capital gains and the effect on markets that include individual as well as corporate investors.

II. ADDITIONAL REVENUE RAISERS

A. Depreciation of Single-Purpose Agricultural or Horticultural Structures

Present Law

Single-purpose agricultural or horticultural structures are assigned a 7-year recovery period under modified ACRS. The Treasury Department may not assign a longer recovery period to single-purpose agricultural or horticultural structures that are placed in service before January 1, 1992.

Description of Proposal

Single-purpose agricultural structures that are used for housing, raising, and feeding poultry would be assigned a recovery period of 8 years, and all other single-purpose agricultural or horticultural structures would be assigned a recovery period of 12 years. The Treasury Department would be prohibited from assigning a longer recovery period to such structures that are placed in service before January 1, 1992.

Effective Date

The provision generally would apply to structures placed in service after December 31, 1988.

An exception would be provided for property acquired after the date of committee action pursuant to a binding contract in existence before that date or property under construction on that date if the property is placed in service before January 1, 1990.

B. Depreciation of Farm Property

Present Law

Property used in a farming business is assigned various recovery periods in the same manner as other business property. In general, the applicable depreciation method is the same for property used in a farming business as property with the same recovery periods used in other businesses. Generally, this method is the 200-percent declining balance method switching to the straight-line method in the later years of the recovery period. Under a special accounting rule, certain taxpayers engaged in the business of farming who elect to deduct preproductive period expenditures, are required to depreciate all farming assets on the alternative depreciation system (i.e., using longer recovery periods and the straight-line method).

Description of Proposal

The applicable depreciation method for any property that is used in the trade or business of farming would be the 150-percent declining balance method switching to the straight-line method at a time to maximize the depreciation allowance, except that taxpayers that elect to deduct preproductive period expenses would continue to use the alternative depreciation system.

Effective Date

The proposal generally would apply to property placed in service after December 31, 1988.

An exception would be provided for property acquired after the date of committee action pursuant to a binding contract in existence on that date if the property is placed in service before July 1, 1989.

C. Reduce Permitted Purpose Arbitrage Earnings on Loans Financed with Tax-Exempt Student Loan Bonds

Present Law

Treasury Department Regulations permit issuers of pooled financing bonds to earn arbitrage profits of 1.5 percentage points on "purpose" investments. Thus, for loans financed with student loan bonds, issuers may charge student borrowers interest rates of up to 1.5 percentage points over the rate paid on the underlying tax-exempt bonds.

The Department of Education pays a special interest subsidy on student notes financed with proceeds of student loan bonds issued in connection with the Federal Guaranteed Student Loan Program. Under present law, these special allowance payments ("SAP" payments) are not included in determining the amount of arbitrage earned on student notes.

The Deficit Reduction Act of 1984 directed the Treasury Department to revise the arbitrage restrictions for student loan bonds. That Act specifically authorized Treasury to provide that SAP payments are included in calculating arbitrage earnings on student notes. To date, these regulations have not been adopted.

Description of Proposal

The proposal would reduce the permitted arbitrage profits on loans financed with tax-exempt student loan bonds from 1.5 percentage points to 1.0 percentage points. In addition, for Federally guaranteed student loan bonds, SAP payments would be included in calculating permitted arbitrage profits on student notes.

Reasons for Change

Issuers of student loan bonds presently are allowed to earn higher purpose arbitrage profits than issuers of any other type of tax-exempt bond. The proposal would adjust these limits to reflect more accurately the costs and risks associated with these bonds. Further, the benefit of the reduced limits will accrue to student borrowers through lower interest rate charges on their loans.

Effective Date

The proposal would apply to bonds (including refunding bonds) issued after July 31, 1988. In the case of refundings of bonds issued before August 1, 1988, the proposal would apply only to loans originated with proceeds of the refunding bonds.

D. Loan Origination Period for Student Loan Bonds

Present Law

Tax-exempt bonds may be issued to finance student loans in connection with (a) the Federal Guaranteed Student Loan Program and the Parents' Loans for Undergraduate Students Program and (b) certain other State programs of general application. Present law imposes no statutory period during which student loans must be originated or bonds redeemed.

The committee bill requires that all net proceeds of qualified mortgage bonds and all pooled financing bonds not subject to State volume limitations be used to originate loans within three years after the bonds are issued. Unoriginated proceeds and loan repayments must be used to redeem bonds.

Description of Proposal

The proposal would require that, like qualified mortgage bonds, all net proceeds of tax-exempt student loan bonds be used to originate student loans within three years after the bonds are issued. Proceeds that had not been used to originate loans by that time, and loan repayments, would be required to be used to redeem bonds within six months after the end of the three-year period (unoriginated proceeds) or before the end of the first semi-annual period after receipt (loan repayments).

Effective Date

The proposal would apply to bonds (including refunding bonds) issued after July 31, 1988.

E. Nondeductibility of Standard Base Charge for Business Use in Home of First Telephone Line

Present Law

Under present law, a taxpayer who uses the telephone in his or her residence partly for business or income-production purposes may deduct a proportionate part of the standard, monthly base charge for the telephone, subject to any applicable limitations on home office deductions or miscellaneous itemized deductions (secs. 162, 212, 280A, and 67).

Description of Proposal

No deduction (under sec. 162 or otherwise) would be allowed for any portion of the standard, monthly base charge (including any sales or excise taxes imposed on such charge) for the telephone line in a taxpayer's residence (whether or not the taxpayer's principal residence). This nondeductibility rule would not affect (1) the deductibility of other types of telephone charges, such as for long-distance calls, or (2) the deductibility of business or income-production use of any additional telephone line in the residence.

Reasons for Change

Individuals necessarily incur a standard, monthly base charge for one telephone line in their residences for personal use (e.g., so that a telephone is available for emergency calls). This charge represents a personal consumption expense, no part of which is deductible by individuals who do not use their telephones for business purposes. It is not appropriate to allow a deduction for any part of the standard base charge for that telephone line merely because the line may also be used for business purposes, since the incurring of the expense is attributable to personal needs.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1988.

F. Disallow Marital Deduction for Foreigners

Present Law

For U.S. citizens and residents, the amount subject to Federal estate and gift tax is determined by reference to all property, wherever situated. For nonresident aliens, the amount subject to those taxes is determined only by reference to property situated in the United States.

For U.S. citizens and residents, the amount subject to Federal estate and gift tax is determined by deducting the value of property passing from the decedent to the surviving spouse, regardless of whether the surviving spouse is a U.S. citizen or resident. As a general matter, however, the marital deduction is available only for property which is includible in the surviving spouse's estate. Estates of nonresident aliens are taxed on a different base and rate structure than estates of U.S. citizens and residents, and are not allowed a marital deduction.

Description of Proposal

Only property passing to spouses who are U.S. citizens would qualify for the marital deduction for Federal estate and gift tax purposes. Aggregate gifts of less than $100,000 per year to alien spouses would, however, continue to qualify for the marital deduction. A marital deduction would be allowed for estate and gift tax purposes for property passing from nonresident aliens to spouses who are U.S. citizens.

Reasons for Change

The marital deduction defers the estate tax on the assumption that the deductible property if not consumed is includible in the surviving spouse's estate. Property passing to aliens may not be so includible.

Effective Date

The proposal would be effective for gifts made after the date of committee action and for decedents dying after the date of enactment.

G. Repeal Special Rates and Credits for Foreign Estates

Present Law

The gift and estate tax rate on U.S. citizens and residents begins at 18 percent on the first $10,000 of taxable transfers and reaches 55 percent on taxable transfers over $3 million. A unified credit of $192,800 is deducted from the gross gift or estate tax in arriving at the net tax payable.

The estate tax rate on nonresident aliens begins at 6 percent on transfers of less than $100,000 and reaches 30 percent on transfers over $2 million. The statute allows such persons a credit of $3,600. Several estate tax treaties, however, have been interpreted to allow treaty country residents the dual benefits of the lower rates and a portion of the $192,800 credit.

Description of Proposal

Estates of nonresident aliens would be subject to the same rates and unified credit as estates of U.S. citizens and residents. A marital deduction would be allowed for property passing from nonresident aliens to spouses who are U.S. citizens.

Reasons for Change

The proposal would conform more closely the estate tax treatment of nonresident aliens and U.S. citizens.

Effective Date

The proposal would be effective for decedents dying after the date of enactment.

H. Treatment of Mortality and Expenses Charges in Life Insurance Contracts

Present Law

Under present law, the undistributed investment income ("inside buildup") earned on premiums credited under a life insurance contract generally is not subject to current taxation to the owner of the contract.

The favorable tax treatment accorded the owner of a life insurance contract is available only for contracts that satisfy a statutory definition of life insurance. Under this statutory definition, a contract must satisfy either a cash value accumulation test or a test consisting of a guideline premium requirement and a cash value corridor test. In determining whether a contract satisfies the cash value accumulation test or the guideline premium requirement, the mortality charges taken into account are the charges specified in the contract, or, if none are specified, the mortality charges used in determining the statutory reserve for the contract. In determining whether a contract satisfies the guideline premium requirement, the expense charges taken into account are the charges specified in the contract.

Description of Proposal

For all life insurance contracts, the mortality charges taken into account for purposes of the definition of life insurance would be required to be reasonable as determined under Treasury regulations and could not exceed the mortality charges required to be used in determining the Federal income tax reserve for the contract. The expense charges taken into account for purposes of the guideline premium requirement would be required to be reasonable based on the experience of the company and other insurance companies with respect to similar life insurance contracts.

Reasons for Change

Concerns have been raised that some insurance companies may be taking aggressive positions with respect to mortality and expense charges. Specifically, life insurance companies may be stating excessive charges in a contract that are never applied or are applied and then later rebated or otherwise credited to the policyholder. Companies argue that such stated charges may be taken into account in determining whether the contract satisfies the definition of life insurance. It is inappropriate to permit the form of a contract, rather than the substance of the contract, to control in determining whether the definition of life insurance is satisfied.

Effective Date

The provision generally would be effective for all life insurance contracts issued on or after July 13, 1988, with special rules for contracts that are materially changed.

I. Cost of Group-Term Life Insurance

Present Law

Under present law, the cost of employer-provided group-term life insurance generally is included in an employee's income to the extent that such cost exceeds the cost of $50,000 of group-term life insurance. In addition, the cost of employer-provided group-term life insurance generally is includible in the income of highly compensated employees to the extent that such insurance is provided on a basis that discriminates in favor of such employees.

In general, the cost of employer-provided group-term life insurance is determined under a table prescribed by the Secretary, which is set forth below. Section 79(c) provides that the cost with respect to any employee older than 63 is to be determined as if such employee were 63. (Because of the 5-year age brackets established by the Secretary, individuals over age 64 are the ones actually receiving special treatment under the table.)

5-year Age Bracket	Cost per $1,000 of protection for 1-month period
Under 30	$0.08
30 to 34	.09
35 to 39	.11
40 to 44	.17
45 to 49	.29
50 to 54	.48
55 to 59	.75
60 to 64	1.17

In the case of discriminatory group-term life insurance, the amount includible in a highly compensated employee's income is the greater of the table cost or the actual cost of the employer-provided group-term life insurance.

Group-term life insurance provided by an employer to certain former employees is subject to special treatment pursuant to a grandfather rule included in the Deficit Reduction Act of 1984. Pursuant to this grandfather rule, the cost of employer-provided group-term life insurance generally is not includible in income without regard to whether it exceeds the cost of $50,000 of insurance or is discriminatory. The former employees entitled to such treatment are (1) any individual who attained age 55 on or before January 1, 1984, and was employed by the employer (or

a predecessor employer) at any time during 1983; and (2) any individual who retired on or before January 1, 1984, and who was, when he or she retired, covered by the plan (or a predecessor plan). This grandfather rule is limited to group-term life insurance plans of the employer (or a successor employer) that were in existence on January 1, 1984, or are comparable successor plans to such plans. In addition, the grandfather rule does not apply to a discriminatory plan with respect to an individual retiring after December 31, 1986.

Description of Proposal

For purposes of the tax treatment of employer-provided group-term life insurance, the cost of group-term life insurance under the table prescribed by the Secretary would reflect the age of the insured, without any special rules for individuals older than age 63. Thus, the table prescribed under section 79(c) would be revised to include table rates for age brackets over age 64.

Reasons for Change

There is no policy rationale for providing that the amount included in income with respect to group-term life insurance provided to individuals over age 64 is less than the actual value of term insurance provided to such individuals.

Effective Date

The provision would apply to group-term life insurance provided after December 31, 1988. However, individuals who continue to be eligible for grandfather treatment under the 1984 Act would not be subject to the provision because employer-provided group-term life insurance would not be includible in their income.

J. Update IRS Valuation Tables Used to Determine Value of Annuities, Life Estates, and Remainder Interests

Present Law

The IRS publishes valuation tables that are used to determine the value of annuities, life estates, and remainder interests. Last published in 1984, these tables assume a 10 percent interest rate. On a monthly basis, the IRS publishes an applicable Federal rate ("AFR"), which is based on the average market yield of obligations of the United States.

Description of Proposal

The IRS would be required to modify the tables used to value annuities, life estates and remainder interests to reflect current mortality assumptions and an interest rate of 120 percent of AFR. This rate approximates the rate of return on investment quality bonds. The AFR in effect when the annuity, life estate or remainder interest is created or transferred would be used in valuing that property.

Reason for Change

The tables used by the IRS in determining the value of annuities, life estates and remainder interests use outdated interest and mortality assumptions. Updating these assumptions will result in more accurate valuation of such interests.

Effective Date

The proposal would apply to annuities issued, and life estates and remainder interests created or transferred, on or after six months after the date of enactment.

K. Excise Tax on Pipe Tobacco

Present Law

Excise taxes are imposed on cigars, cigarettes, cigarette paper and tubes, and on snuff and chewing tobacco. The tax on small cigarettes is 16 cents per pack of 20 cigarettes. Most taxable cigarettes are small cigarettes. Snuff is taxed at 24 cents per pound, and chewing tobacco is taxed at 8 cents per pound.

Description of Proposal

The proposal would impose an excise tax of $2.67 per pound on pipe tobacco.

Reasons for Change

Pipe tobacco should be taxed similarly to other tobacco products. The rate included in the proposal is equivalent to the minimum rate per pound currently imposed on cigarettes.

Effective Date

The provision would be effective for pipe tobacco manufactured or imported after September 30, 1988. Appropriate floor stocks taxes would be imposed on tobacco held beyond the point of manufacture or importation on October 1, 1988.